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SUBJECT: TREASURY DEPUTY SECRETARY WOLIN EMPHASIZES IMPORTANCE OF
SOUND PUBLIC FINANCIAL MANAGEMENT AND GOVERNANCE

SUMMARY

¶1. (SBU) During a February 10-11 visit to Kabul, Treasury Deputy Secretary Wolin promoted sound public financial management and governance in meetings with senior Afghan officials, including Central Bank Governor Fitrat and Finance Minister Zakhilwal and in a speech at the American University of Afghanistan. The Deputy Secretary pressed for strong anti-money laundering/ combating terrorist finance efforts in meetings with the Central Bank's financial intelligence unit FinTRACA, urged more attention to sub-national governance with Minister of Rural Rehabilitation and Development Mansoori, and discussed anti-corruption with Ashraf Ghani, whom President Karzai has asked to play a lead role in developing a coherent national strategy in this area. The Deputy Secretary also launched the recently-formed Financial Services Advisory Group at a dinner hosted by the Ambassador. End Summary.

CENTRAL BANK STRENGTHENS BANKING SUPERVISION

¶2. (SBU) In a February 10 meeting with Central Bank Governor Fitrat, Treasury Deputy Secretary Wolin discussed banking supervision, combating illicit finance, increasing access to finance, monetary policy, and joint efforts to grow the Afghan economy. Wolin emphasized the importance of robust banking supervision and effective anti-money laundering and combating the financing of terrorism (AML/CFT) measures. Governor Fitrat responded that the Banking Supervision Department was relatively new (established in 2003, with USG support) and that it had been strengthened in recent years, with additional staff for on-site supervision (from the banking supervision office, financial intelligence unit, and risk management office) and that off-site supervision was based on monthly data collected from all banks operating in Afghanistan. The Central Bank conducts full scope bank examinations every six months, resulting in two full cycles per year, Fitrat stated.

¶3. (SBU) Governor Fitrat asserted that various banks have taken steps to lift their CAMEL ratings and address Central Bank concerns over poor asset quality. (Note: "CAMEL ratings" measure a bank's capital, assets, management, earnings, and liquidity. End Note) The Central Bank had forced several banks to "make their loans current" i.e., not delinquent for more than 30 days. Fitrat claimed that the non-performing loan rate was 0.74, although some financial sector observers dispute how the Central Bank calculates this figure. He also said the Central Bank now requires external audits of all banks by one of the big four international auditors (KMPG, PwC, Deloitte, Ernst & Young) and obliges banks to make audited financial reports public. Fitrat also observed that access to credit is improving and that Afghanistan's international ranking in the World Bank's Access to Finance 2009 report had risen from 180 to 127.

14. (SBU) When Deputy Secretary Wolin pressed for the need to combat illicit finance more diligently, Fitrat described improvements within FinTRACA, the Central Bank's financial intelligence unit. According to Fitrat, the Central Bank has licensed more than five hundred foreign exchange dealers and 416 money service providers, mainly hawalas, throughout the country. Hawala licensing is lagging in the South and Southeast due to security concerns, he added, but vowed to continue efforts to address these deficiencies.

SAUDI RIYAL MOVEMENT

15. (SBU) Fitrat highlighted the Central Bank's efforts to track the large movement of Saudi Riyals in Afghanistan, which he believes originate in Pakistan, and to establish whether this flow is related to terrorist financing. (Note: the Treasury Attach Office brought this issue to the Governor's attention in January and has followed-up several times. End Note) Fitrat stressed that he needed more clarity on this issue, which would require cooperation from other Afghan ministries working on borders and customs issues (particularly Interior and Finance).

CEILING ON CURRENCY IN CIRCULATION

16. (SBU) Governor Fitrat asked for Treasury support in raising Afghanistan's currency-in-circulation ceiling (CiC) under the IMF program - the Poverty Reduction and Growth Facility (PRGF), which is scheduled to expire in June. The PRGF originally established a

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ceiling of 16% year-on-year growth for currency-in-circulation, later raised to 22%. Fitrat argued that this rate was too low given real growth of 15% this Afghan calendar year and the deflationary pressures facing the country. The low ceiling for CiC growth has resulted in an appreciation of the Afghani, which undermines the competitiveness of Afghan exports and contributes in part to the 40% fall in exports in the last year. Fitrat said that the currency appreciation represents significant losses on the Central Bank's balance sheets (as its holdings of foreign exchange are now worth less relative the stronger Afghani), and that the Central Bank is losing close to \$1 million/day from this. The IMF ceiling target is undermining Afghanistan's economic growth, Fitrat said, and asked Deputy Secretary Wolin to take up this issue with IMF headquarters in Washington. (Note: On February 16, the IMF Resident Representative told Treasury Attache that Afghan core inflation is still high, which necessitates IMF enforcement of the 22% CiC ceiling. The Treasury Attach Office asked the IMF Resident Representative to engage the Central Bank as soon as possible on this issue. End Note)

SUPPORT FOR DEPOSIT INSURANCE FUND

17. (SBU) Governor Fitrat raised the issue of creating a deposit insurance fund, noting that depositors have been seeking some form of guarantee. Observing that the Central Bank had \$21 million of the target \$30 million deposit insurance fund on hand (with \$10 million contributions from DAB and MOF respectively and \$1 million from the banks), Fitrat requested donor support for the \$9 million shortfall. Deputy Secretary Wolin pointed out that deposit insurance schemes in the United States are entirely funded by private banks and do not come from public funds. Fitrat agreed that banks should eventually bear the full cost of deposit insurance and committed to withdrawing public funds over time, but argued that the infusion of public funds is necessary to start up the program and build confidence in the banking system.

STRENGTHENING PUBLIC FINANCIAL MANAGEMENT

¶8. (SBU) Deputy Secretary Wolin also delivered a speech at the American University of Afghanistan to more than 100 students on the importance of strengthening public financial management systems to reduce opportunities for corruption and increase Afghan government capacity to manage development funds. The American University of Afghanistan is Afghanistan's only private, not-for-profit institution of higher education and serves as the training ground for many of the country's future leaders.

¶9. (SBU) Noting that the Treasury Department plans to send more advisors to strengthen Afghanistan's public financial management system, Deputy Secretary Wolin also described how advisors have already assisted Afghanistan to restructure its debt, streamline its budget process, improve its payment system for government employees, and stand up a debt management unit at the Ministry of Finance. He argued that stronger public financial management systems would help address corruption and ensure resources reach their intended beneficiary.

LAUNCH OF THE FINANCIAL SERVICES ADVISORY GROUP

¶10. (SBU) Deputy Secretary Wolin emphasized the importance of a transparent and credible financial sector to the future of Afghanistan during a dinner hosted by Ambassador Eikenberry that helped formally launch the Financial Services Advisory Group (FSAG). The FSAG -- which includes U.S., UK, EU, World Bank, and IMF participation, along with representatives from the Afghan financial sector and government -- will meet regularly to identify emerging issues, hear from industry leaders, and develop strategies to strengthen the formal financial sector.

BOOSTING REVENUE COLLECTION, IMPROVING BUDGET EXECUTION,
AND ADDRESSING CORRUPTION

¶11. (SBU) In a February 11 meeting, Deputy Secretary Wolin discussed with Finance Minister Zakhilwal the importance of creating more transparent and accountable revenue and customs collection procedures, the "clustering concept" designed to better organize key ministries under proven reform leaders, increasing budget execution rates and effectiveness, and the need for more robust public

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financial auditing of expenditures. Zakhilwal noted that the Ministry of Finance had studied how to improve budget execution and was targeting the seven line ministries that execute 70% of the budget for technical support. He identified a "lack of capacity" as the greatest obstacle to higher budget execution numbers. Zakhilwal also expressed appreciation for Treasury's technical support in the areas of budget and debt management, and welcomed the addition of additional advisors in the area of internal audit.

¶12. (SBU) Minister Zakhilwal claimed that anti-corruption efforts have improved revenue collection, which according to internal estimates, will surpass Afs 65 billion this year and represent a significant increase year-over-year. (Note: The IMF target this year is Afs 54 billion. End Note) Wolin pressed the minister to replace ineffective management at state-owned Pashtany Bank, prompting Zakhilwal to respond that he would be "surprised" if new leadership were not in place in two weeks and cited the need to ensure that a "good CEO" replaces the current one.

¶13. (SBU) (Note: On February 13, Deputy Minister of Finance for Customs and Revenue Gul Sabit told Treasury Attache that he had been confirmed by the shareholders of Pashtany Bank (which is essentially the Ministry of Finance) as the new CEO, pending confirmation by the Central Bank. This is a significant breakthrough and a direct consequence of Deputy Secretary Wolin's one-on-one conversation with Finance Minister Zakhilwal. The Central Bank later confirmed Sabit and he took over as CEO on February 19. End Note)

STRENGTHENING SUB-NATIONAL GOVERNANCE

¶14. (SBU) At another meeting with Finance Minister Zakhilwal and Rural Rehabilitation and Development Minister Jarullah Mansoori, U.S. participants noted that strengthening sub-national governance requires greater efforts to facilitate the flow of information from the provinces to the center, while at the same time building greater budgeting capacity at the point of execution to manage resources flowing down. To this end, Zakhilwal noted efforts by the Finance Ministry to strengthen their internal Treasury Department and to bring all mustofiat (Ministry of Finance regional office) heads together for more frequent meetings.

COMMENT

¶15. (SBU) Deputy Secretary Wolin's trip highlighted the critical need for Afghanistan to improve dramatically key areas of public financial management as part of its efforts to ensure long-term success. Achieving our strategic objectives in Afghanistan relies, in large part, on the ability of the government to collect an increasing percentage of its annual expenditures through revenues from customs, minerals, and non-tax fees, etc., to budget effectively, and to deliver services on time and in alignment with need. We must remain committed to strengthening the Central Bank and promoting a robust and transparent financial sector. We will follow-up on the Deputy Secretary's meetings and aggressively push forward these themes.

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CLEARANCE PAGE

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